

FILED

AUG 24 2005

T.S. MCGREGOR, CLERK  
U.S. BANKRUPTCY COURT  
EASTERN DISTRICT OF WASHINGTON

UNITED STATES BANKRUPTCY COURT  
EASTERN DISTRICT OF WASHINGTON

In re:

No. 04-00756-W1B

METROPOLITAN INVESTMENT  
SECURITIES, INC.,

MEMORANDUM DECISION RE:  
RONALD PELLEGRINO'S MOTION  
FOR LIMITED RELIEF FROM  
AUTOMATIC STAY (#507)

Debtor.

Mr. Ronald Pellegrino was the general manager and briefly the President of Metropolitan Investment Securities, Inc. ("MIS") prior to the termination of the debtor's business in December, 2003. Mr. Pellegrino held various licenses as a securities representative from National Association Securities Dealers ("NASD"). After an investigation, NASD commenced disciplinary proceedings against Mr. Pellegrino in which it seeks to impose undefined sanctions. As a former officer and director of MIS, Mr. Pellegrino sought reimbursement for the costs of defending himself in the investigation and disciplinary proceeding from the primary D&O insurance policy for the three debtors, Metropolitan Mortgage & Securities Co., Inc., Summit Securities, Inc. and Metropolitan Investment Securities, Inc. That policy was issued by National Union Insurance ("National Union") and is policy No. 263-38-69 which is the subject of the interpleader adversary No. 05-80135-PCW. It is also one of the policies referenced in the Court's

MEMORANDUM DECISION RE: . . . - 1

1 Memorandum Decision issued June 20, 2005 in the adversary  
2 proceeding *Metropolitan Mortgage & Securities, Inc., et al. v.*  
3 *Keith Cauvel, et al.*, No. A04-00061-PCW, which determined that the  
4 proceeds of certain insurance policies constituted property of the  
5 bankruptcy estates. National Union has advised Mr. Pellegrino that  
6 it would pay the costs of defense under a reservation of rights.  
7 Without payment of the costs of defense from the policy proceeds,  
8 Mr. Pellegrino would be unable to fund the defense. He is without  
9 employment and is contemplating a personal bankruptcy.

10 The moving party in its Motion for Limited Relief from  
11 Automatic Stay and in its oral argument seeks two forms of relief:  
12 (1) A determination that the continuation of the disciplinary  
13 proceeding constitutes a violation of the automatic stay; and (2)  
14 a lifting of the automatic stay to allow the costs of defending the  
15 proceeding be reimbursed from the insurance proceeds. NASD argues  
16 that the stay does not preclude the commencement or continuation of  
17 the disciplinary proceeding. Other objecting parties contend that  
18 allowing distribution of some of the policy proceeds to reimburse  
19 the costs of defense would deplete property of the estate and  
20 should not be allowed.

21 The written decision issued June 20, 2005 (Adversary No. A04-  
22 00061-PCW, Docket No. 223) concluded that the proceeds of the  
23 insurance policies constitute property of the estate. Pursuant to  
24 11 U.S.C. § 362, any act to collect or exercise control over that  
25 property, i.e., a request to receive distribution of the proceeds,  
26 would violate the automatic stay. That decision does not discuss  
27 whether the continued existence of any specific lawsuit or  
28 arbitration proceeding violates the automatic stay.

MEMORANDUM DECISION RE: . . . - 2

1        Issue: Is the Commencement or Continuation of the Disciplinary  
2        Proceeding Stayed by 11 U.S.C. § 362?

3        As a general proposition, the stay does not prevent the  
4        commencement or continuation of any legal proceeding by a third  
5        party against a non-debtor even though the factual situation which  
6        gave rise to the legal proceeding involved conduct of a debtor. In  
7        this situation, the third party, the NASD, has commenced a  
8        disciplinary action against Mr. Pellegrino, a non-debtor. Even  
9        though Mr. Pellegrino may have been employed by a debtor, nothing  
10       in 11 U.S.C. § 362 precludes the third party from taking action to  
11       impose sanctions, monetary or otherwise, against that non-debtor.

12       Naming non-debtors as defendants and asserting claims against  
13       the non-debtors is not a violation of the stay. Even though such  
14       non-debtors may be jointly liable with a Chapter 7 or Chapter 11  
15       debtor, their status as a joint obligor does not extend the  
16       protections of the stay to them. Should one of the debtors be  
17       named as a defendant or should a particular legal proceeding seek  
18       "to recover a claim against the debtor," § 362(a)(1) stays the  
19       legal proceeding. It is conceivable that some of the legal  
20       proceedings referenced in the prior decision regarding insurance  
21       policy proceeds would be subject to § 362(a)(1). However, it  
22       appears that many of the legal proceedings now pending name only  
23       non-debtors and seek to recover only claims against non-debtors.  
24       Those legal proceedings would not be stayed. Any disputes  
25       regarding applicability of § 362(a)(1) to a particular proceeding  
26       would have to be resolved on a case-by-case basis. This NASD  
27       disciplinary proceeding does not attempt to realize upon a claim  
28       against the debtor and its continuation does not violate

MEMORANDUM DECISION RE: . . . - 3

1 § 362(a)(1).

2 Issue: Should the Stay be Lifted to Allow Mr. Pellegrino to  
3 Seek Reimbursement of His Costs of Defense From the Insurance  
4 Proceeds?

5 11 U.S.C. § 362(a)(3) does preclude any action to collect or  
6 exercise control over property of the estate. Even though the  
7 litigation itself does not violate the stay, any attempt to seek  
8 reimbursement of defense costs or payment of a monetary judgment  
9 from property of the estate would violate the stay. The proceeds  
10 of certain insurance policies constitute property of one or more of  
11 the bankruptcy estates. Any attempt to exercise control over those  
12 policy proceeds, such as seeking a distribution of the proceeds  
13 violates § 362(a)(3).

14 In other words, the continuation of the legal proceedings  
15 referenced in the prior decision violate the stay only to the  
16 extent there is an attempt to effect property of the estate, i.e.,  
17 an attempt to collect a judgment or settlement amount resulting  
18 from the legal proceeding. Mr. Pellegrino's request is that the  
19 automatic stay be lifted so that he may effect property of the  
20 estate, i.e., receive a distribution of the insurance proceeds to  
21 reimburse his defense costs in this legal proceeding.

22 There appears to be a dispute as to whether Mr. Pellegrino is  
23 entitled to receive benefits under the National Union policy and  
24 share in the policy proceeds. This, however, is not the forum or  
25 procedure to resolve that dispute. He seeks permission to seek a  
26 distribution from the policy proceeds to pay his costs of defense  
27 and for purposes of this motion, it should be assumed that he would  
28 be entitled to do so under the terms of the policy.

Mr. Pellegrino argues that cause exists to lift the automatic

MEMORANDUM DECISION RE: . . . - 4

1 stay to allow the defense costs to be paid. He is unable to pay  
2 those costs and the disciplinary proceeding could potentially  
3 result in extremely serious long term adverse consequences. It is  
4 likely, however, that many individual defendants to the numerous  
5 lawsuits, NASD arbitration proceedings and class action litigation  
6 are similarly situated. Even though the defense costs requested by  
7 Mr. Pellegrino may be only a small portion of the policy proceeds,  
8 as was previously found in the decision regarding the insurance  
9 proceeds, the cumulative costs of defending all those legal  
10 proceedings will greatly deplete the policy proceeds. As  
11 sympathetic as the Court may be to those defendants who have no  
12 means to pay the very significant costs of defense or any judgment,  
13 any diminution of the proceeds reduces the value of the debtors'  
14 rights to the insurance proceeds, thus potentially reducing  
15 property of the estate otherwise available to pay creditors.

16 Balancing the rights of claimants such as Mr. Pellegrino  
17 against the rights of the bankruptcy estates, leads to the  
18 conclusion that the interest of the bankruptcy estates in the  
19 policy proceeds must be preserved. As a general proposition, the  
20 stay should not be lifted to allow distribution of insurance policy  
21 proceeds. If a situation exists in which the equities require a  
22 different result, the merits would have to be addressed in the  
23 context of a motion addressing that situation.


24 Lastly, the effect of the existing interpleader action No. 05-  
25 800135-PCW must be considered. That adversary proceeding was  
26 commenced by National Union and placed the proceeds of policy No.  
27 263-38-69 into the registry of the Court. The Complaint seeks a  
28 determination of the respective interests of the numerous parties

1 who are, or may be, entitled to receive the policy proceeds.  
2 Lifting the automatic stay to allow Mr. Pellegrino or similarly  
3 situated defendants to seek reimbursement of defense costs or even  
4 payment of monetary judgments rendered against those defendants is  
5 inconsistent with the orderly administration of the interpleader  
6 action and the orderly resolution of the issues in that adversary  
7 proceeding.

8 CONCLUSION

9 The automatic stay is not applicable to the NASD litigation  
10 against Mr. Pellegrino. However, the automatic stay prohibits  
11 Mr. Pellegrino from seeking reimbursement of his defense costs, and  
12 Mr. Pellegrino has not shown cause for lifting the stay.

13 DATED this 24<sup>th</sup> day of August, 2005.

14  
15   
16 PATRICIA C. WILLIAMS  
17 Bankruptcy Judge  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28